



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

April 22, 2008

Number: **200833024**

Release Date: 8/15/2008

EO

LEGEND

ORG = Organization name XX = Date Address = address

UIL: 501.03-01

ORG

Person to Contact:

ADDRESS

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN:

CERTIFIED MAIL – Return Receipt Requested

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: July 21, 20XX

Dear :

This is a final revocation letter as to your exempt status under section 501(c) (3) of the Internal Revenue Code. The Internal Revenue Service's recognition of your organization as an organization described in section 501(c) (3) is hereby revoked effective January 1, 20XX. You agreed to the change in the proposed action per signing of Form 6018 on January 28, 20XX.

We have made this determination for the following reasons:

You have not demonstrated that you are operated exclusively for charitable, educational, or other exempt purposes within the meaning of I.R.C. section 501(c) (3). Organizations described in I.R.C. section 501(c)(3) and exempt under section 501(a) must be organized and operated exclusively for an exempt purposes. You have provided no information regarding your receipts, expenditures or activities. You have not established that you have operated exclusively for an exempt purpose.

As such, you failed to meet the requirements of I.R.C. section 501(c)(3) and Treas. Reg. section 1.501(c)(3)-1(d) in that you failed to establish that you were operated exclusively for an exempt purpose.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1041. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling, Tel: (213)-576-3140, or write:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Marsha A. Ramirez
Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

March 4, 2008

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear ,

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Lois G. Lerner
Director, Exempt Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG -		Year/Period Beginning 01/01/20XX

LEGEND

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 and 2nd companies

ISSUE

Whether ORG operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501 (c) (3).

FACTS

Background

ORG (Organization) is a Texas not-for-profit corporation incorporated on March 3, 19XX. is the Organization's registered agent; its address is Address, City XYZ. It was granted tax exempt status effective October 8, 19XX.

Federal Returns

The Organization's Form 990 for December 31, 20XX, reported no activity related to the operation of a Down Payment Assistance Program. The Organization reported that its activity was "[t]o assist individuals to attain affordable housing via the CO-2." According to the Form 990 filed by ORG for the year ending December 31, 20XX, the amount of \$ in notes receivable is due from the CO-1.

The Organization reported no educational programs / activities for the home buyer on Forms 990 filed for the years the DPA Program was operating. The president President stated in an interview that the Organization decided to take a new direction to become a part of the CO-1 and the CO-2 of the City, XYZ, in connection with the redevelopment project for land deemed to be blighted by the city. In 20XX the Organization reported over \$ in gross receipts; for 20XX the Organization reported only \$ in receipts. Its gross receipts for 20XX were \$. Its total expenses in the amount of \$ included the following: (1) compensation of officers in the amount of \$; (2) other salaries in the amount of \$; payroll tax in the amount of \$; (3) accounting fees in the amount of \$; (4) telephone expenses in the amount of \$ (5) office space in the amount of \$; (6) depreciation in the amount of \$; and (7) other expenses in the amount of \$ including insurance expenses in the amount of \$ and \$ for administrative expenses.

Organization's Activities

In a letter from the Organization's representative Representative., dated May 23, 20XX, the Organization states that it did operate a down payment assistance (DPA) program for home buyers for the years ending December 31, 20XX, and 20XX. The down payment assistance program was described by Representative in an interview on July 31, 20XX. Representative stated that in 19XX the founders of the Organization modeled its down payment assistance

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program on a business model similar to one used by for-profit affiliates in which the executives had financial relationships. The Organization relied on home sellers (both home builders and individual homeowners) to fund the down-payments.

A brief description of how the down payment assistance program worked is as follows:

- 1) After the buyer began to look for a house, the real estate agent informed the client about the down payment assistance program.
- 2) After the buyer located a house to purchase and began negotiations with the seller, the seller was informed about the program and the tax benefits of the program. The seller then completed a DPA seller participating agreement/contract.
- 3) Once an agreed-upon price was reached, the amount of the down payment was calculated; this amount was added to the previously agreed-upon sales price.
- 4) Escrow was instructed to withdraw from the seller's closing statement the same amount as the down payment and to categorize it as a contribution to the not-for-profit entity.

In addition to the above, the Organization charged the seller a fee for each property sold. This fee was generally a small percentage of the total sales price for individual sellers or a flat fee for builders and was the primary revenue source for the organization. The Organization provided services to home sellers for which it charged a market rate fee. The Organization did not solicit or receive any donations or funds from parties that did not have direct benefit from participating in the down payment transactions.

The home sellers entered into agreements that require them to make payments to the Organization in the amounts of the down payment assistance. The organization acknowledged this amount as a charitable contribution and the home seller claimed a charitable deduction. The home seller received the same amount as that for which a charitable deduction was claimed when the home was sold; the selling price was inflated to include the amount of the down payment assistance grant, creating a circular tax flow of money.

The Organization did not provide down payment assistance unless the seller entered into a contract that required a payment from the seller equal to the amount of assistance that was going to be offered to the buyer. The Organization would offer a down payment assistance grant to the home buyer, only if the seller agreed to give the amount of the grant to the Organization.

Neither promotional materials nor advertising information were located during the research of the down payment assistance program for the Organization.

Form 1023 Application for Recognition of Exemption

Some of the activities stated on the application for exempt status are as follows:

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- 1) Through resources which include federal, state and local grant and bond funds, provided as part of government programs designed to provide affordable housing, as well as grants from other public charities and private foundations and gifts and contributions from private individuals, the Foundation will implement a home buyer assistance program which will provide down payment assistance to low-to-moderate income individuals seeking to purchase a single family residence.
- 2) The foundation plans to provide comprehensive credit counseling for low- to moderate income individuals. The program will provide individualized, pre-purchase credit counseling which focuses on educating potential home buyers regarding the importance of good credit in securing a mortgage loan. Unlike other programs which only provide short (usually four hours or less) in office, in classroom or by phone counseling, the foundation will, to the extent necessary, take a longitudinal approach to personal finance and consumer credit education on personal finance, budgeting, and credit.
- 3) The Foundation seeks to establish home owner maintenance and community support groups in the communities in which these individuals live. By securing federal, state, and local grants as well as through partnerships with local businesses and national corporation the Foundation will seek charitable donations of money as well as general maintenance equipment including gardening tools and implements, lawnmowers and lawn care equipment. Through classroom education and practical demonstration the Foundation will provide support to first time home buyers to teach them the responsibilities of owning and maintaining a home and a community.
- 4) The Foundation's primary fund-raising program will be drafting of grant proposals and submission of such proposals to federal, state, and local government authorities responsible for awarding funds earmarked for home ownership and home buyer needs and submission of similar grant proposals to the above named foundations and charities for similar assistance within the context of funds each such foundation may have earmarked for programs contemplated by the Foundation.

In contrast to these statements made on the application, (1) the Organization obtained funding only from the home sellers or builders who received substantial direct benefits from participating in the organization's Down Payment Assistance Program; (2) the organization never provided credit counseling or education to any home buyer; (3) no community support groups were established and no classroom education was provided to the home buyer; and (4) as noted previously, the Organization received substantially all of its funding from home sellers and home builders.

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The Internal Revenue Services granted the organization its IRC section 501(c)(3) tax exempt status based on the information submitted on Form 1023, Application for Recognition of Exemption. The activities stated on Form 1023 never occurred. The organization provided down payment assistance in a manner that provided benefit to the sellers and did not further exempt purposes.

LAW & ARGUMENT

Treasury Regulation section 1.501(c)(3)-1(d)(2) states that charitable purposes include relief of the poor and distressed. The Organization's down payment assistance program does not operate in a manner that relieves the poor and distressed. The Organization granted qualified home buyers money to help them obtain loans to purchase homes; the home sellers inflated the selling prices of homes by the amounts of down payment assistance provided such that the home buyers paid the money back at the closing. The Organization's down payment assistance program activity does not qualify as an exempt activity as described in Internal Revenue Code section 501(c)(3).

Treasury Regulation section 1.501(c)(3)-1(d)(1) states that even though an organization's activities serve a charitable class or are otherwise charitable within the meaning of section 501(c)(3), the organization must demonstrate that its activities serve a public rather than a private interest. Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests. . The organization's down payment assistance program benefits the home seller.

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Treasury Regulation section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of section 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business. The Organization's down payment assistance program is the primary activity for the organization; the way that the program is

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operated would not be classified as a charitable activity described under section 501(c)(3). The organization's primary activity was the facilitation of the buying and selling of homes.

In Easter House v. United States, 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir. 1988), the Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under section 501(c)(3). The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman's child sponsored the care financially. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in section 501(c)(3). The Organization operated in a similar manner since it did not provide down payment assistance to a potential buyer unless the home seller entered into a contract that required a payment from the seller equal to the amount of financial assistance (plus an additional fee) that would be provided to the home buyer.

Revenue Ruling 20XX6-27, 20XX-21 C.B. 915, in part, discusses whether down payment assistance organizations described in 3 situations operate exclusively for charitable purposes. Those described in Situations 1 and 2 are relevant to this discussion. The organization described in Situation 1 helps low-income families to purchase decent and safe homes in the metropolitan area in which it is located. Individuals are eligible to participate if they have the employment history and financial history to qualify for a mortgage with the exception that they do not have the funds necessary for down payments.

The organization in Situation 1 offers financial seminars, conducts educational activities to prepare the individuals for home ownership, and requires a home inspection report before providing funds for down payment assistance. To fund the program, the organization conducts broad based fundraising that attracts gifts, grants, and contributions from the general public. Further, the organization has policies in place to ensure that the grant making staff does not know

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the identity or contributor status of the home seller or other parties who may benefit from the sale and does not accept contributions contingent on the sale of particular properties.

Because the organization described in Situation 1 relieves the poor and distressed, requires a home inspection to ensure the house is habitable, conducts educational seminars, had a broad based funding program, and has policies to ensure that the organizations is not beholden to particular donors, the Service held that the organization is operated exclusively for charitable purposes and qualifies for exemption from federal taxation as an organization described in section 501(c)(3).

The organization described in Situation 2 is similar to the organization described in Situation 1 except that (1) its staff knows the identity of the party selling the home and may know the identity of the parties involved in the sale; (2) the organization receives a payment from the seller (the amount of which bears a direct correlation to the amount of down payment assistance provided) in substantially all the cases in which the organization provides assistance to the home buyers; and (3) most of its financial support comes from home sellers and related businesses that may benefit from the sale of homes to buyers who receive assistance from the organization.

Because the organization described in Situation 2 provides down payment assistance amounts that directly correlate to the amounts provided by home sellers and real estate related businesses that stand to benefit from the transactions to finance the program, the Service held that the organization described in Situation 2 is not operated exclusively for exempt purposes and does not qualify for exemption from federal income tax as an organization described in section 501(c)(3).

Organization's Position

The Organization agrees with the government's position with respect to the issues, facts, and applicable law and signed Form 6018 Consent to Proposed Action-Section 7428 on January 1, 20XX, which states that the exempt status of the Organization is to be revoked as of January 1, 20XX.

Government's Position

The government proposes revoking the Organization's exempt status as an organization described in section 501(c)(3), effective January 1, 20XX. The Organization operated a down payment assistance program that most resembled the organization described in Situation 2 of Revenue Ruling 20XX-27; its main revenue source was generated from a fee charged to the

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home seller for the completion of the sale of the home. Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose.

The Organization solicited no public contributions associated with the down payment assistance program. The home seller or builder made payments in the amounts of the down payment amounts in addition to fees. The Organization operated its down payment assistance program in a manner which provided more than insubstantial private benefit to the home sellers. Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Conclusion:

When active, the Organization's down payment assistance program was the primary activity for the organization; its activity furthered no exempt purpose. Since the Organization was not operated exclusively for an exempt purpose, its exempt status as an organization described in section 501(c)(3) should be revoked effective January 1m 20XX.

Form 1120 returns should be filed for all tax periods after December 31, 20XX.